NEW YORK LIFE INSURANCE COMPANY,

Petitioner,

against

WILLIAM H. EDWARDS, as Collector of Internal Revenue, etc.

WILLIAM H. EDWARDS, as Collector of Internal Revenue, etc.,

Petitioner,

against

NEW YORK LIFE INSURANCE COMPANY.

REPLY BRIEF FOR THE INSURANCE COMPANY.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1925.

No. 712.

NEW YORK LIFE INSURANCE COMPANY, Petitioner,

AGAINST

WILLIAM H. EDWARDS, as Collector of Internal Revenue, etc.

No. 804.

WILLIAM H. EDWARDS, as Collector of Internal Revenue, etc., Petitioner,

AGAINST

NEW YORK LIFE INSURANCE COMPANY.

REPLY BRIEF FOR THE INSURANCE COMPANY.

FIRST.

As to the Collector's first point relating to portions of actual premiums received and credited.

In my original brief filed in No. 712 I have anticipated and I think for the most part answered the Collector's argument on this subject, and I shall not repeat here what I said there.

As in the courts below, so here, the Collector pins his faith to the *Penn Mutual* case. At page 29 of my original brief I show that the issue in the *Penn Mutual* case is entirely different from the issue here. I have not thought it worth while to discuss in this court the question that a decision on one issue is not decisive of the merits of an entirely different issue, and shall not discuss it now. And yet as I read and re-read the Collector's argument, it seems to me it is practically all gone if you eliminate from it the *Penn Mutual* case.

Nor have I thought it necessary to remind this court that general expressions in the court's opinion in the *Penn Mutual* case are to be taken in connection with the issue in that case only. And yet the Collector asks this court to disregard the plain language of this statute by depriving the important word credited of all practical meaning and effect because in the course of the discussion in the *Penn Mutual* case the court said,—"The principle applied is that of basing the taxation on receipts of net premiums, instead of on gross premiums". And so the Collector insists, and I understand this to be the basis of his whole argument, that unless the portion of actual premium received and credited correspondingly reduces the policyholder's current premium, it does not come within this clause of the law. At the conclusion of his argument on this subject he says at page 22 of his brief,—

> "The dividends there (in the *Penn Mutual* case) were held to be nondeductible, not because they were dividends, but because they had not been applied to abate or reduce the current premiums of the respective policyholders, and, therefore, did not reduce the gross premiums of the company to net premiums."

This practical elimination of the word credited was the basis of the opinion of the majority of the Court of Appeals, and I answer it to the extent that I thought it required an answer at page 32 of my original brief.

But let us see if "The principle applied is that of basing the taxation on receipts of net premiums, instead of on gross premiums".

FIRST. What is there in this law to justify this statement? As I understand the law, the principle applied is a tax, not on net premiums, but on net income derived from gross income, not including therein portions of actual premiums received which are paid back, credited or treated as an abatement of premium, less the deductions the law authorizes. And gross income consists not merely of premiums but also of income from invested funds, from rents, from profits on the sale of securities, and of income from every other source. I can find nothing in the law to indicate any intention to base the tax upon receipts of net premiums.

SECOND. Net premium in life insurance means the gross or Table Rate of Premium less the loading (R. 40, paragraph Twelfth).

THIRD. But if net premiums as used in the *Penn Mutual* case in the clause above quoted means the gross premiums less the over-payments "used to abate or reduce the full premium", still I can find in the law no support for the principle,—because the law puts over-payments *credited* and over-payments *applied in abatement of premium* in the same category, and accords to each of them the same treatment. Besides, if only over-payments which reduce gross premium receipts come within this clause of the law, then over-payments credited can have no meaning or practical effect at all, because no over-payment credited can in any way, directly or indirectly, reduce gross premium receipts.

Hence, if this clause of the law means what the Collector claims it means, then portions of actual premium received and credited does not mean anything.

SECOND.

As to losses sustained by the amortization of securities purchased above par.

At page 28 of the Collector's brief he says,—

> "The loss, if any, could be deducted only in the year such loss is actually sustained; that is, at the maturity of the securities, if the plaintiff held them until that time, or in any year prior thereto in which they were sold for less than cost."

But it is too late now to apply this rule.

Besides, if this was the Commissioner's rule, he should have applied it in auditing the Company's return. Not having done so, he should now be estopped to object to the method the Company employed. Whichever rule was followed would make little or no difference; certainly no difference in the long run. And shall the Commissioner be permitted to collect a tax he is not entitled to receive because the Company did not know and follow the rule he now approves, but followed another rule equivalent in its results, approved by the best accountants and used in every well managed office,—the Commissioner himself, while rejecting the results of the Company's rule, not having given it the benefit of the equivalent rule which he says applies?

THIRD.

As to "the net addition, if any, required by law to be made within the year to reserve funds".

All the judges who heard the case have agreed with the Company on this subject.

First. The court will notice this clause of the law speaks of reserve funds,—in the plural. The Collector wants the court to limit it to the singular and confine it to the policy reserve only.

If Congress had intended to limit this clause to the policy reserve, we have a right to assume they would have said so. There is the same sound sense in the rule which requires a taxing statute in case of doubt to be construed against the government and in favor of the taxpayer that there is in the rule which requires a life insurance policy in which the meaning is doubtful to be construed against the Company and in favor of the insured. In the one case the government, in the other the Company, knew what it wanted, had a free field for expressing its intention, and itself wrote the instrument in words chosen by it. If under such conditions there is doubt, the law, which in its purest form is only crystallized good sense, gives the party affected by the instrument who had no hand in drawing it the benefit of the doubt.

Therefore, when Congress said in this clause of law, reserve funds, the taxpayer has a right to insist Congress meant reserve funds, and not merely the policy reserve.

Second. What are reserve funds as the phrase is used in this law and in the business of insurance?

Already the court has so well answered this question that no amount of technical knowledge or even of captiousness can

fairly add to it or take from it. In the *Maryland Casualty* case you said,—

> "The term 'reserve' or 'reserves' has a special meaning in the law of insurance. While its scope varies under different laws, in general it means a sum of money, variously computed or estimated, which, with accretions from interest, is set aside, 'reserved', as a fund with which to mature or liquidate, either by payment or reinsurance with other companies, future unaccrued and contingent claims, and claims accrued, but contingent and indefinite as to amount or time of payment."
>
> *Maryland Casualty Co.* v. *United States*, 251 U. S. 342.

THIRD. When is a reserve fund required by law?

When it is required directly by statute, or by a public official who has authority to require it?

Now let us look at the reserve funds in dispute here and see whether or not they are reserve funds required by law.

1. As to the reserve for disability benefits, paragraph Twenty-second, page 53.

This is a part of the policy reserve.

Some of the Company's policies contain (R. 53) "a clause under which it agreed that upon receipt before default in the payment of premium of due proof that the insured had become totally and permanently disabled the plaintiff would waive payment of any premium thereafter falling due".

Hence, one of the Company's obligations contained in its insurance contract is to carry the insurance without further payment of premium if the policyholder becomes permanently disabled. The laws of the state require the Company to carry a reserve fund to meet all its policy obligations. To carry the insured without further payment of premium if the policyholder becomes disabled is one of the obligations of these policies. Hence the reserve fund.

The total premium on all such policies contains a sum

which pays for this benefit and from this sum in the premium the reserve is created.

The Collector says at page 33 of his brief,—

> "It is clear that under the laws of New York the only legal reserve of a life insurance company * * * is the premium reserve, equivalent to the socalled 'value' of its policies, the amount necessary to reinsure its risks."

Now let us test this question by the Collector's own views as above stated about what constitutes reserve funds required by law in New York. Suppose the Company were to reinsure a risk or all its risks under policies which provide for waiving the further payment of premiums if the insured becomes permanently disabled. Could it reinsure them without transferring to the reinsurer a reserve which would enable it to perform the obligation contained in the policy which required it to carry the insurance without further payment of premium if the insured became permanently disabled?

I am satisfied the Commissioner became confused by the way this reserve appeared in the Company's 1913 annual report. The insurance commissioner who prepares the form for the Company's annual reports, adopted the plan in 1913 of requiring the Company to state separately in its annual report the amount of this reserve fund. In all previous reports, the Company carried it where it properly belonged, that is, in its general policy reserve for all its policies (R. 53, f. 159 *et seq.*).

2. As to reserve fund to meet death losses which have occurred, but which have not been reported to the Company during the calendar year, paragraph Twenty-fourth, page 55.

> "The Superintendent of Insurance, acting under the authority given him by the laws of the State, requires the plaintiff to carry, and it does carry, a special fund to meet the plaintiff's liabilities upon these losses which have occurred but which have not been reported" (R. 55, ff. 165, 166).

The Collector in his brief makes some point of the fact that the phrase "special fund" is used in the above quotation from the agreed statement of facts, and that the phrase "reserve funds" is not used. It should be plain to the court that we never could have agreed on the facts if the Company had stood out here for the use of the phrase "reserve funds" instead of "special funds", and the Company assented to the use of this phrase because it did not think it would make any difference and it does not think so now.

Let us test this special fund by the court's above quoted definition of reserve and see whether or not it comes within that definition. It is "a fund with which to * * * liquidate * * * by payment * * * claims accrued, but contingent and indefinite as to amount" and time of payment.

Thus it is a reserve fund, and it is a reserve fund required by law because (R. 55) "The Superintendent of Insurance, acting under the authority given him by the laws of the state, requires the plaintiff to carry" it.

3. As to the reserve to meet life annuities payable to certain soliciting agents, paragraph Twenty-fifth, page 56.

> "The plaintiff has a form of contract of employment with many of its soliciting agents under which, if such agents for a period of twenty years continuously devote their entire time, talents and energies in soliciting applications for insurance, and if they shall for the twenty years accomplish certain prescribed minimum results, then at the end of twenty years of such service each such agent becomes entitled to an income for life payable monthly" (R. 56).

The statutes of New York as well as the lawful orders of the Superintendent of Insurance require the Company to carry a reserve fund to meet these annuities.

Section 84 of The Insurance Law requires the Superintendent of Insurance annually to "make a valuation of all outstanding policies, additions thereto, unpaid dividends and all other obligations of every life insurance corporation doing business in the state", and provides that "the legal

minimum standard for the valuation of annuities issued after January first, nineteen hundred and seven, shall be McClintock's 'Tables of Mortality among Annuitants', with interest at four per centum per annum".

In addition to this direct requirement of law, the Superintendent of Insurance (R. 57, f. 169) "requires the plaintiff to carry and it does carry a fund to meet its said liabilities on said contracts". This "fund" too, like the special fund spoken of with respect to unreported death losses, is a reserve fund, as above defined by the court. It is a fund held to meet future unaccrued and contingent claims on annuity contracts.

Respectfully submitted,

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17 February, 1926.